

DEPARTMENT OF THE TREASURY
Office of Public Affairs

April 6, 2005

FACT SHEET:

New Temporary and Proposed Regulations on U.S. Possessions Residency and Source Rules

Overview

In the American Jobs Creation Act of 2004 (AJCA), Congress clarified and supplemented the U.S. tax rules dealing with U.S. possessions in particular the determination of: (1) residency in a possession, and (2) whether income is possession source or effectively connected with the conduct of a possession trade or business.

The temporary and proposed regulations generally provide guidance with respect to American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands under the new possession rules in AJCA and update guidance under other sections of the Internal Revenue Code to reflect amendments made by AJCA and the Tax Reform Act of 1986.

Residency Rules

- Under the regulations announced today, an individual is generally considered a bona fide resident of a possession if (1) he or she is physically present in the possession for 183 days during the taxable year and (2) meets certain other conditions.
- The regulations provide certain exceptions to the 183-day test. Individuals who meet the following requirements will be considered to have met the 183-day test:
 - o Individuals who spend no more than 90 days in the United States during the taxable year;
 - o Individuals who spend more time in a possession than in the United States and do not have any U.S. earned income; or
 - o Individuals who have no permanent connection to the United States.
- There are days of presence in the United States that are not counted for purposes of these three exceptions. For example, time spent in the U.S. as part of an individual's official duties as a government official or employee of a possession is not counted.

Effective date: These regulations generally apply to taxable years ending after October 22, 2004. However, the 183-day test and the exceptions to it are effective for taxable years beginning after October 22, 2004.

****MORE****

Source Rules

- Generally, the regulations provide that the principles for determining whether income is U.S. source are applicable for determining whether income is possession source. Similarly, the principles for determining whether income is effectively connected with the conduct of a U.S. trade or business are applicable for purposes of determining whether income is effectively connected to a possession trade or business. However, the regulations also generally provide that:
 1. Income from U.S. sources is not considered income that is possession source or effectively connected with the conduct of a possession trade or business; and
 2. Income that is effectively connected with the conduct of a U.S. trade or business is not treated as possession source income or effectively connected with the conduct of a trade or business in a possession (the U.S. income rule).
- The regulations provide the following exceptions to these rules:
 - o The regulations preserve the existing treatment of income from the sale of goods manufactured in a possession, which provide for the allocation of this income between U.S. and possession sources;
 - o The regulations provide rules to prevent U.S. citizens and residents from avoiding U.S. tax on appreciated property by becoming resident in a possession prior to the property's disposition in certain instances;
 - o The regulations also provide certain anti-abuse rules for determining the source of dividends and interest from possession corporations.

Effective date: These regulations are generally effective for income earned after October 22, 2004 or after the publication of the regulations. The U.S. income rule is effective for income earned after December 31, 2004.

****END****